No. 11829

In the United States Circuit Court of Appeals for the Ninth Circuit

Mitchell Camera Corporation, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The only previous opinion is the memorandum findings and opinion by the Tax Court entered June 24, 1947 (R. 26–68), which is not reported.

JURISDICTION

The petition for review (R. 71–83) involves federal income taxes for the taxable year 1941. On February 27, 1945, the Commissioner of Internal Revenue mailed to the taxpayer notice of a deficiency in income tax in the amount of $71,301.66. (R. 10–19.) Within ninety days thereafter, and on May 15, 1945, the taxpayer filed a petition with the Tax Court of the United States for redetermination of such deficiency under the provisions of Section 272 of the Internal Revenue

Code (R. 2), and thereafter, on November 4, 1946, it filed an amended petition (R. 3, 5–9). The decision of the Tax Court, redetermining the deficiency in the amount of $47,720.78, was entered September 9, 1947. (R. 68.) The proceeding is brought to this Court by the petition for review aforesaid, which was filed November 3, 1947 (R. 4, 71–80), under the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTIONS PRESENTED

1. Whether there is warrant in the record for the Tax Court's finding and holding that the taxpayer was not entitled to a deduction under Section 23 (l) of the Internal Revenue Code in the taxable year 1941 on account of depreciation of certain patents acquired by it in 1929.

2. Whether the Administrative Procedure Act has application here.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> *   *   *   *   *
>
> (l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
>
> (1) of property used in the trade or business, or * * *.
>
> (n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be al-

lowed in respect of any property shall be as provided in section 114.

(26 U. S. C. 1940 ed., Sec. 23.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

*   *   *   *   *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

*   *   *   *   *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws. * * *

(26 U. S. C. 1940 ed., Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

(26 U. S. C. 1940 ed., Sec. 114.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

> SEC. 19.23 (l)–7. *Depreciation of patent or copyright.*—In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced is the cost or other basis of the patent or copyright. The allowance should be computed by an apportionment of the cost or other basis of the patent or copyright over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or in the case of a copyright, since March 1, 1913, as the case may be. * * * The fact that depreciation has not been taken in prior years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable.

STATEMENT

The facts as found by the Tax Court (R. 28–57), including those stipulated (R. 22–25), may be summarized as follows:

While this proceeding involves only a deficiency in the taxpayer's income taxes for the taxable year 1941, the determination of that amount requires the ascertainment of its correct net income for the taxable years 1939 and 1940, because of the carry-over net losses claimed by it for those years. (R. 26–27.)

Prior to May, 1929, one Harley L. Clarke was interested in acquiring the business and assets of the Mitchell Camera Corporation, a California corporation (hereinafter called "Mitchell of California"). Two-thirds of the stock of this corporation was owned

by one Henry F. Boeger and one-third by one George A. Mitchell. The corporation was in the business of manufacturing professional motion picture cameras and accessories for the large motion picture studios in California, all of its products being manufactured under patents which it owned. (R. 28–29.)

In 1929 one William Fox was generally engaged in the motion picture business and was the general manager of the taxpayer at the time of the hearing of this case, his family controlling its stock. (R. 29.)

In May, 1929, Clarke and Fox entered into an agreement or understanding for the formation of a corporation to be known as Grandeur, Incorporated (hereinafter called "Grandeur"), one-half of whose stock was to be subscribed for by each. It was also understood and agreed that another corporation was to be formed to take over the assets of Mitchell Camera of California which should either be independently operated by them or should be a wholly owned subsidiary of Grandeur, as should thereafter be mutually agreed upon between them or between their respective counsel. (R. 29–31.)

Thereafter, on June 6, 1929, Clarke entered into a contract with Boeger and Mitchell for the sale to him of all the assets of Mitchell of California for $1,475,-000, $100,000 of which was forthwith to be deposited in escrow in a Chicago bank. (R. 31–32.) Boeger and Mitchell obligated themselves for a period of five years after the consummation of the purchase not to engage in the motion picture camera business other than with Clarke or a new corporation to be formed by him. They also agreed to enter the employ of the

new corporation in the same capacities as they had served Mitchell of California, at a stated salary of $25,000 each per year beginning July 1, 1929. (R. 33–34.)

On June 13, 1929, Grandeur was incorporated under the laws of New York, one-half of its stock being acquired by Fox and one-half by Clarke for a stated consideration of $4,000,000, under circumstances hereinafter described. (R. 34.)

On July 11, 1929, General Theatres Equipment, Inc. (hereinafter called "G. T. E."), was organized for the purpose of taking over certain properties owned by Clarke, who owned "just over control" of its stock. (R. 38.)

On July 12, 1929, the taxpayer was organized and, on the same day, Clarke made a proposal to the taxpayer to transfer to it all the properties, business and assets of Mitchell of California for a stated consideration of $3,100,000 in cash. The proposal referred to a balance sheet, annexed thereto, which showed a net worth (capital stock and surplus) of $330,480.50 for Mitchell of California as of December 31, 1928; and, in the proposal, Clarke represented to the taxpayer that, at the date of its acquisition of the assets of Mitchell of California, the taxpayer's financial condition would be at least as good as was reflected on the balance sheet annexed to the proposal. (R. 40.)

On July 16, 1939, Clarke, Boeger and Mitchell, acting as directors of the taxpayer, accepted Clarke's proposal, as well as a proposal of Grandeur (of which Clarke was the president), to acquire all of the taxpayer's capital stock for $3,100,000. (R. 40–42.) And

Grandeur purchased the taxpayer's stock, but "as of July 1, 1929," for the stated sum of $3,100,000. (R. 29.)

On July 27, 1929, Mitchell of California transferred its assets, other than patents, direct to the taxpayer, all constituting a party of the property included in the contract of June 6, 1929, above referred to, to be sold to Clarke by Boeger and Mitchell for a consideration of $1,475,000; also on the same day there was transferred to the taxpayer by Mitchell of California and Boeger and Mitchell some thirty patents and patent rights on which patents were ultimately obtained. (R. 42–43.)

The final consideration of $1,475,000 under the terms of the June 6, 1929, contract between Clarke and Boeger and Mitchell, was not paid to Boeger and Mitchell until the fall of 1929 (R. 44)—actually on August 24, 1929 (R. 48).

On August 1 and 2, 1929, a series of concurrent financial transactions occurred in effectuating the acquisition by Grandeur of the capital stock of the taxpayer and consummating the acquisition by the taxpayer, through Clarke, of the business and assets of Mitchell of California. (R. 44.) These may be summarized chronologically as follows:

On August 1, 1929, G. T. E. received $11,400,000 from the sale of its securities. Of this $2,000,000 was used to acquire fifty percent of the capital stock of Grandeur and $3,000,000 to acquire four corporations, J. E. McCauley Manufacturing Company, Strong Electric Company, Ashcraft Automatic Arc Company

and Hall & Connolly, Inc. (hereinafter referred to as "the four lamp companies").[1] And, on the same date, Clarke deposited $5,000,000 to his credit in the Chase National Bank of New York resulting in a balance in his account on that date of $5,025,024.29. (R. 45.)

Also on the same day, Clarke issued two checks to Fox aggregating $2,000,000 against this account. For the two checks received from Clarke, Fox by check paid into Grandeur on the same date $1,950,000 towards one-half of its capital stock, having put up with Clarke prior thereto $50,000 as down payment to apply to the purchase of the assets of Mitchell of California. In this connection, Fox testified that he had given the "Harley Clarke Interests" $2,000,000 in checks in exchange for the $2,000,000 in checks which he had received from Clarke. (R. 45–46.)

Clarke's bank account referred to showed a similar withdrawal of $1,950,000 on August 2, 1929, in addition to the withdrawal of $2,000,000 on the same date by way of the two checks to Fox. (R. 46.)

On August 1, 1929, Grandeur issued a check for $3,000,000 payable to Mitchell Camera Corporation (the taxpayer), signed "Grandeur, Inc., by H. L. Clarke, President," which was honored by the bank on August 2, 1929, and shown by it as withdrawn from Clarke's account on that date and deposited on the same date to the account of Grandeur. (R. 46–47.)

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[1] As regards the purchase of these four companies, the Tax Court found that out of G. T. E.'s $11,400,000 fund $3,000,000 was paid to Clarke to acquire the four lamp companies; but, to acquire these, Clarke paid only $1,757,422.93. (R. 48.)

Also on August 2, 1929, Clarke's account showed a deposit of the taxpayer's check of $3,000,000. This was shown as credited on the bank's statement immediately prior to Clarke's withdrawal of the $2,000,000 and $1,950,000 referred to. (R. 47.)

After the consummation of these check transactions on August 1 and 2, G. T. E. owned one-half of the stock of Grandeur at a cost of $2,000,000,[2] and Fox owned the other half at no cost to him.[3] Grandeur, in turn, owned and continued to own through the taxable year 1941 all the capital stock of the taxpayer, which it carried on its books at a value of $3,100,000. The July 1, 1929, statement of assets and liabilities disclosed that of the total of $3,900,000 represented by the two checks for $1,950,000 each which Fox and Clarke had given it, Grandeur retained $900,000 undisbursed cash, to be used as working capital. (R. 47.)

The amount of $1,475,000 paid by Clarke to acquire the business and assets of Mitchell of California was obtained by him from G. T. E. out of its $11,400,000

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[2] This sum apparently represented the $1,950,000 check which Clarke drew in the order of Grandeur, plus the $50,000 which Clarke had deposited in escrow pursuant to his agreement with Boeger and Mitchell, of date June 6, 1929, for which he appears to have reimbursed himself out of the $5,000,000 he had received from G. T. E.

[3] While, of course, Fox got his half interest without cost to himself, it was paid for as will hereafter appear from the findings, by G. T. E.; for, as above stated, Clarke gave Fox two checks aggregating $2,000,000 out of the $5,000,000 he had received from G. T. E., for which Fox gave Grandeur his check for $1,950,000, keeping the balance of $50,000 to reimburse himself for the $50,000 he had contributed to the escrow deposit under the agreement of June 6, 1929, between Clarke and Boeger and Mitchell. The Tax Court so found, as hereafter stated.

fund. Clarke had deposited $100,000 on or before July 1, 1929, under the June 6, 1929, agreement of which Fox had advanced $50,000. Fox was, however, later reimbursed for this $50,000 advance by the check for $2,000,000 dated August 1, 1929, received from Clarke, in exchange for his $1,950,000 check to Grandeur. (R. 47–48.)

Clarke paid the balance due under the June 6, 1929, contract with Boeger and Mitchell of $1,375,000, plus interest of $14,627.58, or a total of $1,389,627.58, on August 24, 1929. (R. 48.)

In addition to the two checks aggregating $2,000,-000, Clarke gave Fox 25,000 shares of G. T. E. stock at $30 per share with a repurchase agreement valued at $750,000. G. T. E. had approximately 2,000,000 shares outstanding. (R. 48.)

Grandeur and the taxpayer filed consolidated returns for the period July 1, to December 31, 1929. The statement of assets and liabilities of the taxpayer included net tangible assets valued at $239,821.25, good will at $2,805,157.59, patents at $55,021.36, and capital stock outstanding of $3,100,000. A deduction for depreciation on all assets of $7,765.94 was claimed by the taxpayer in the return, and no adjustment of depreciation claimed was made by the Commissioner. (R. 49.)

The 1930 consolidated income tax return of Grandeur and the taxpayer reported net income of $84,-213.47. Patents were reported at a net value of $52,-961.28 at the beginning of the year, and at a value of $92,768.11 less a reserve for depreciation of $42,028.91, or a net value of $50,739.20, at the end of the year,

and a value of $2,805,157.59 was reported for good will, franchise rights and going concern value, both at the beginning and end of the year. The deduction for depreciation of patents claimed on the return was $5,347.98, or approximately one-seventeenth of average basis of $92,518.61. (R. 49–50.)

In 1931, the consolidated income tax return of Grandeur and taxpayer reported patents at a value of $92,768.11 less a reserve for accumulated depreciation of $42,028.91, or a net value of $50,739.20 at the beginning of the year, and at a value of $94,833.11 less a reserve for depreciation of $47,514.16, or a net value of $47,318.95 at the end of the year, and a value of $2,805,157.59 was reported for good will, franchise rights, and going concern value at both the beginning and end of the year. The deduction for depreciation of patents claimed on the return was $5,485.25, or approximately one-seventeenth of $94,833.11. (R. 50.)

Prior to the closing of the returns for the taxable years 1930 and 1931, Grandeur and the taxpayer filed consolidated returns for 1932 reporting a net loss of $102,819.84. In its statements of assets and liabilities attached to the return, the value of the taxpayer's good will was reported at $1,555,157.59 as at the beginning and end of the year, and the value of its patents at $1,344,833.11 as at the beginning and at $1,345,-909.91 as at the end of the year. These figures reflected a write-down of $1,250,000 in the good will account and an identical write-up of that amount in the patent account, compared with 1931 closing balances. Accordingly, the opening 1932 balances showed good will at $1,555,157.59 and patents at $1,344,833.11;

the amount deducted for depreciation for that year being $106,676.73, which was not changed by the Commissioner. (R. 52.)

However, in 1934, additional depreciation was allowed on account of the patents upon a revised basis. The patents were valued as of the date of the acquisition by the taxpayer in 1929 at $1,180,157.59, being the difference between the cost price of the assets it purchased from Mitchell of California at that time of $1,475,000 less the value of the net assets other than good will or $294,842.41. Considering the life of the patents to be 12.3666 years, $95,430.50 was allowed on account of patent amortization, resulting in an additional allowance on that date of $90,082.52 for 1930 and $89,945.25 for 1931. (R. 50–51.)

The taxpayer accepted these adjustments by a waiver agreement, which the Bureau in turn accepted by letter dated April 19, 1934. (R. 51–52.) Thereafter, in the taxable years 1933 to 1940, inclusive, patent depreciation was claimed by the taxpayer and allowed by the Commissioner on that basis. (R. 53–54.) Accordingly, there was allowed in 1940 $49,187.34 on account of the remaining unexhausted portion of the cost value of the patents of $1,180,157.59, as agreed to in 1934, with the result that no amount was allowed for such depreciation in 1941. (R. 55.) During these years—that is from 1933 to 1940, inclusive—good will was reported at $1,555,157.59 (that being the amount at which it had been reported in 1932). (R. 53–54.)

In the year 1941, however, the taxpayer reported as at January, 1941, good will at nothing and patents at

$105,895.54, but as at December 31, 1941, good will at $1,680,021.36 and patents at $1,198,892.12. (R. 54.)[4]

For the years 1939, 1940, and 1941, the taxpayer reported net losses in the following amounts, respectively, $87,952.61, $163,282.50 and $7,121.24. (R. 54.)

Both Boeger and Mitchell were employed by the taxpayer for a period of years after 1929. Clarke was the controlling stockholder of G. T. E. and its president, as also the president of Grandeur. (R. 56.)

It was stipulated that the fair market value of the tangible property acquired by the taxpayer through Clarke from Mitchell of California was $239,821.05; also that, in computing the deficiency the Commissioner determined the basis of the taxpayer's patents, applications for patent, and inventions, acquired by the taxpayer, as aforesaid, to be $1,180,157.59. Accordingly he allowed depreciation of $95,430.50 for the year 1939, $49,187.34 for 1940 and nothing for 1941, arriving at the allowance for 1939 by spreading the basis over the average life of the patents, namely 12.3666 years (R. 23); it being further stipulated that the Commissioner's allocation of basis of patents was based on the price of $1,475,000 paid by Clarke to the

[4] It is to be noted that the figure of $1,198,892.12 returned as the cost of patents as of December 31, 1941, represents the July 25, 1929, cost figure agreed to in 1934 of $1,180,157.59, plus additions. (R. 14, 55.) Accordingly, the $1,680,021.36 returned as the value of good will as of December 31, 1941, is arrived at by subtracting the $1,180,157.59 figure from the cost of the patents, now claimed by the taxpayer (see its amended petition (R. 5)) of $2,860,178.95. That figure, in turn, is arrived at by subtracting the stipulated value of the net taxable property of $239,821.05 (R. 23) from the $3,100,000 figure which the taxpayer claims to have paid Clarke for the assets of Mitchell of California.

stockholders of Mitchell of California for all of its properties, business and assets under the contract dated June 6, 1929 (R. 24).

In the taxable year 1941, the taxpayer claimed a deduction on account of patent depreciation of $94,-605.94 (R. 54), which the Commissioner reduced by $93,578.16 (R. 13), the difference of $1,027.78 representing allowances for depreciation on account of additions made in 1939, 1940 and 1941 (R. 55). The taxpayer's claim for a deduction to the extent of $93,578.16 is based on its claim that the cost of the patents to it was $2,860,178.95, representing the amount it claimed to have paid therefor in 1929 of $3,100,000 less $239,821.05, the fair value of the tangible assets then acquired by it. (R. 6–7, 57.)

The Tax Court sustained the Commissioner's determination insofar as it was based upon a disallowance of $93,578.16, the amount of patent depreciation claimed by the taxpayer (R. 57–67), on the ground that the taxpayer had not proved that the actual cost of the assets and business of Mitchell of California was in excess of $1,475,000. (R. 64.) The Tax Court further sustained the Commissioner's determination that the value of the net assets other than good will was $294,842.41 and not $239,821.05 which the taxpayer had asked to be substituted as the stipulated value of tangible assets. The reason given by the Tax Court is that the record amply demonstrated that intangible assets of substantial value exclusive of good will were received among the assets acquired from Mitchell of California, such, for example, as the agreements of the two organizers and operators of Mitchell

of California not to engage in this line of business for a period of years, as also a large backlog of contracts, which alone might have been worth the difference in the two figures. (R. 65–66.)

And, finally, the Tax Court concluded that, since the taxpayer acquired all of the patents of Mitchell of California, approximately thirty in number, no basis for allocation of the individual cost of each existed; hence, that the formula based on the average remaining life of the patents computed at 12.3666 years was properly used, and further that such formula had consistently been applied, the taxpayer having taken depreciation each year upon such basis, thereby exhausting the entire basis prior to the taxable year, so that it could not, after the exhaustion of its basis, recompute its allowances according to another formula. (R. 66–67.)

SUMMARY OF ARGUMENT

I

The problem here presented is one of accounting. Review of the Tax Court's decision is, therefore, governed by the principles of the *Dobson* case. A separate consideration of the component elements of the problem makes this clear. These are (1) the question as to what the taxpayer's patent cost was, such cost being its depreciation base; and (2) the question as to what formula should have been used in spreading the depreciation allowances over the lives of the thirty patents it had purchased. These questions are answered in their inverse order.

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A. The formula used by the taxpayer in all of the taxable years from 1930 to 1940, inclusive, was the so-called "average life" formula, which spread the deductions over a period of 12.3666 years from the date the taxpayer purchased the patents in 1929. This period expired in 1941, the taxable year here in question; but, due to larger allowances for prior years than allowable under the formula, the taxpayer's patent cost had been entirely amortized by a final allowance made in 1940. The Tax Court has approved the use of this formula in this case. The formula has often been used by taxpayers with the approval of the Board of Tax Appeals and Tax Court, where the March 1, 1913 value of a group of patents was involved, or where, as here, a number of patents were purchased by the taxpayer and it was impossible to allocate a portion of the cost to the various patents in the group. It has, moreover, also been approved by several federal courts.

The taxpayer now claims for the first time that the "Simmons" formula is the only proper one to be used because of alleged conformity with the Regulations and should, therefore, have been used. The Simmons formula is so called because the Board of Tax Appeals approved its use in the case of *Simmons Co.* v. *Commissioner,* 8 B. T. A. 631. The Simmons formula does not, however, conform strictly to the provisions of the Regulations dealing specifically with the depreciation of patents, any more than does the average life formula. The reason is that the Regulations do not purport to deal with the amortization of a group of patents, but only of a single patent, in which case

the rule is that its March 1, 1913, value or cost, as the case may be, must be amortized over the life of the patent, or its remaining life, unless obsolescence is a factor. In the *Simmons* case, moreover, the Commissioner and the taxpayer had stipulated that reasonable depreciation allowances would result by its use there, and the Board of Tax Appeals had merely said that it saw no reason why it would not. By the use of this formula, the allowances were spread over the combined lives of the 131 patents involved in that case. The facts which satisfied the use of this formula there were, however, different from those here presented, and there is no reason to use it here. Furthermore, so far as we are aware, the Simmons formula has not been used since in any case which has reached either the Board of Tax Appeals, the Tax Court, or the federal courts.

B. As early as 1934, the Commissioner and the taxpayer had agreed that the taxpayer's patent cost was \$1,180,157.59, and that figure was used by the taxpayer as its patent depreciation base for the years 1930 to 1940, inclusive. This base was exhausted, however, as stated, in 1940. The evidence otherwise fully supports the Tax Court's finding that this amount (with an addition claimed by the taxpayer of \$55,021.36 which is now conceded) represents the taxpayer's patent cost. The taxpayer is not entitled to a further addition thereto of \$350,000 or \$400,000, which it claims was expended from its account by way of commissions in the acquisition of the patents. The Tax Court apparently discredited the testimony of the witness Clarke, who testified with regard to such alleged

expenditures, and for that reason refused to allow an increase in the taxpayer's patent cost on account thereof. The Tax Court committed no error in this respect.

II

The procedural provisions of the Administrative Procedure Act have no application to the Tax Court, or to the appellate court's review of its decisions. The dictum of the Sixth Circuit in its decision in the *Lincoln Electric Co.* case is erroneous. It has not been followed by that Court or by any other Circuit Court of Appeals and has specifically been disapproved by the Seventh Circuit in the *Anderson* case.

ARGUMENT

I

There is warrant in the record for the Tax Court's finding and holding that the taxpayer was not entitled to a deduction under Section 23 (l) of the Internal Revenue Code in the taxable year 1941 on account of depreciation of certain patents.

The problem presented

The problem here presented is one of accounting. Contrary to the taxpayer's various contentions, there are no questions of law, and certainly none of general importance, involved. There are, therefore, no errors in the Tax Court's decision which this Court could be called upon to correct, unless it be a mathematical error made by the Commissioner, and perpetuated by the Tax Court, in the computation of the taxpayer's patent cost, hereinafter referred to. The fact of the matter is that is would be difficult, indeed, to find a

case more clearly governed by the principles of *Dobson* v. *Commissioner,* 320 U. S. 489. A separate consideration of the various elements of the problem will clearly establish this.

Thus, in the first place, the question whether the taxpayer was entitled to a deduction in 1941 on account of patent depreciation depends primarily upon whether the cost of the thirty patents it had acquired from or through Harley L. Clarke in 1929 was $2,860,-178.95, as it contends (Br. 24–27), or $1,180,157.59, as the Commissioner determined (R. 13–14, 54–55), and as the Tax Court found (R. 61–62, 64). The taxpayer's figure of $2,860,178.95 represents the difference between $3,100,000 which it claims to have paid for the assets of Mitchell of California, less $239,821.05, the stipulated value of the "net tangible property" acquired by it. (R. 23.) On the other hand, the figure used by the Commissioner and approved by the Tax Court of $1,180,157.59 represents the amount of $1,-475,000 which was actually paid by Clarke—and, as the Commissioner determined and the Tax Court found, by the taxpayer—to Mitchell of California for its assets, less the amount of $294,842.41, which the Commissioner determined to be that portion of such amount representing the cost of the "net assets other than good will." (R. 51, 61.)

The Tax Court regarded the question whether the taxpayer's cost of the patent was $2,860,178.95 or $1,-180,157.59 as being one of fact. We think that the Tax Court's appraisal of the nature of this issue is the correct one.

There are two other matters in connection with the cost figures which require explanation.

The first involves the Commissioner's error in the computation of the taxpayer's patent cost, already referred to. The error lies in the treatment given by the Commissioner to an item of $55,021.36, which the taxpayer had initially set up on its books as the cost of the patents. (R. 48–49.) It will be noted that, in arriving at the $2,860,178.95 patent cost figure, the taxpayer added the $55,021.36 figure to the figure $2,805,157.59, then set up on its books as representing the cost value of good will. (R. 51–52.) But, for the purpose of its return for 1941, the taxpayer transferred this amount to its patent account. Hence the $2,805,157.59 figure is also the amount which taxpayer claimed as being the cost of the patents in its original petition,[5] and it is the patent cost figure disclosed on the taxpayer's Exhibit 16, which was prepared by the taxpayer's accountant, Sydney R. Reed, and used by him in illustrating his testimony.[6] (R. 108.) Of course, if the $55,021.36 figure should be added to the $2,805,157.59 figure in determining the taxpayer's cost of the patents at $2,860,178.95, it should obviously

[5] While the original petition is not included in the printed record, the taxpayer will not dispute this fact. In any event, the statement here made of a fact *de hors* the record is made only for the purpose of clarifying the issue, and not for the purpose of obtaining any argumentative advantage.

[6] At this point is should be observed that the figure $2,185,179.59, which the record shows as the one given by Reed (R. 108), is a typographical error. There is no such figure. Obviously it should be the figure $2,805,157.59 given, as stated, on the taxpayer's Exhibit 16.

likewise be added to the $1,180,157.59 figure, which the Commissioner and the Tax Court determined as the taxpayer's cost of the patents, thus increasing it to $1,235,178.95. We think the taxpayer's contention as regards the true character of the $55,021.36 figure is correct and should have been accepted by the Tax Court. It follows that the Tax Court erred in sustaining the Commissioner's contention that this figure represented good will, or rather that the taxpayer had not established otherwise. (R. 63.) Briefly, the situation with regard thereto appears to be as follows:

In determining Mitchell of California's tangible assets at $294,842.41, the Commissioner accepted the Revenue Agent's report dated January 5, 1934. (R. 51.) But this report actually included the amount of $55,021.36, at which the taxpayer, as stated, was then carrying the cost of its patents as of July 1, 1929; and, as appears from a statement of assets as of that date which is attached to its 1929 return (R. 49), the $55,021.36 figure is the difference between the amount of $294,842.41 and the amount of $239,821.05, which is the stipulated value of the "net tangible property" acquired by the taxpayer "from or through H. L. Clarke" (R. 23).

The second matter bearing upon the cost of the patents is the taxpayer's contention (Br. 27–29) that Clarke paid between $350,000 and $400,000 as commissions in acquiring the assets of Mitchell of California. But the payment of commissions, if any, is relevant only if the patent cost as determined by the Commissioner, of $1,180,157.59, is accepted; for in no

event could the $2,860,178.95 cost figure, contended for by the taxpayer, be increased, for that is based upon the assumption that $3,100,000 was paid by the taxpayer *to Clarke*—not *by Clarke* for the taxpayer—for the assets of Mitchell of California.

But whether Clarke actually paid such commissions, or any commissions, in connection with the acquisition by him of the assets of Mitchell of California was also regarded by the Tax Court as presenting a fact question, and we think its appraisal of the character of that question is likewise correct.

This leaves for consideration the taxpayer's contention that the Tax Court erred in using the so-called "average life" formula for determining the annual depreciation allowances, it being the taxpayer's claim that the "Simmons" formula, so called because its use was approved by the Board of Tax Appeals in the case of *Simmons Co.* v. *Commissioner,* 8 B. T. A. 631, affirmed on another point, 33 F. 2d 75 (C. C. A. 1st), certiorari denied, 280 U. S. 588, should have been used. The average life formula is a method of computing the amount of annual patent depreciation allowances over the composite average life of a group of patents. The average life is determined by dividing the aggregate of the unexpired life of the patents in the group by the number of patents therein. In order, then, to obtain the amount of the annual allowances, the value or cost of the group is divided by the average life. The aggregate unexpired life of the patents in this case, as stipulated in the taxpayer's Exhibit 8, was 361 years, 120 months; and this was divided by 30, the number of patents in the group, to arrive at the

average life figure of 12.3666 years, and it was this figure which was used by the taxpayer in computing its annual depreciation allowance for the years 1930 to 1940, inclusive. By the use of the "average life" formula, the taxpayer's cost, as determined by the Commissioner and approved by the Tax Court, was fully exhausted by allowances made in years prior to the taxable year 1941. On the other hand, the Simmons formula is based upon the total number of patent life months, in this case 4,452. Under it, the depreciation allowance in any given year during the 4,452 patent life months period is represented by a fraction of the cost of which the number of patent life months expiring in a given year is the numerator and the total number on the date of the acquisition of the unexpired patent life months in the period is the denominator. Thus, for example, since in the taxable year there expired 204 patent life months, the fraction for that year would be 204/4452, which the taxpayer contends should be applied to whatever the patent cost is determined to be, that is, to either the cost claimed by the taxpayer to be $2,860,178.95, or to the cost claimed by the Commissioner and found by the Tax Court to be $1,180,157.59, as corrected.[7]

We believe that it will serve the purpose of clarity best if we discuss the matter of the formula first, and

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[7] But, for reasons hereafter pointed out, under the principles of *Virginian Hotel Co.* v. *Commissioner*, 319 U. S. 523, the Simmons formula can, in any event, be applied only to the unallowed balance of the taxpayer's cost as of December 31, 1938, if the cost figure as determined by the Commissioner and approved by the Tax Court, namely $1,180,157.59, is used.

then the matter of the cost of the patents. Thus, we shall take up the two points involved in the issue in the case in the inverse order to that in which the taxpayer has discussed them, and shall finally briefly consider, under a separate heading (Point II), whether the Administrative Procedure Act has any application here.

A. The Tax Court committed no error in approving the amortization of the taxpayer's patent cost over the average life of the patents of 12.3666 years

In the case of a single patent, the rule is that deductions for depreciation are allowed over its life, i. e., seventeen years, unless obsolescence becomes a factor prior to the end of that period. *Hazeltine Corp.* v. *Commissioner,* 32 B. T. A. 4, 19. See to similar effect Section 19.23(1)–7 of Treasury Regulations 103, promulgated under the Code and applicable to the taxable year 1941, here in question.

But the Board of Tax Appeals early recognized that a literal adherence to this rule would deprive the taxpayers of all patent depreciation deductions where the March 1, 1913, value of a group of patents expiring at different dates was involved, or where such group was purchased by the taxpayer. For, in such a case, each patent could not be separately valued, and this difficulty would render valuation generally impossible. Accordingly, in the first case which came before it for the allowance of depreciation deductions of a group of patents based upon their March 1, 1913, value, the Board of Tax Appeals denied the Commissioner's contention that no depreciation deductions should be allowed because of the impossibility of evaluating each patent, and held that deductions were

permissible under the statute over the average life of the patents. This rule has been called the average life formula, and has been continuously applied ever since. From a perusal of the cases in which the rule has been invoked, it appears that the interdependence of the patents is a primary consideration and that in the hands of separate owners they would have little value; also that, in the case of group patents, some of the patents often represent improvements on others and the value of the group consists largely in the combination of the various patents therein. *Union Metal Manufacturing Co.* v. *Commissioner,* 4 B. T. A. 287, 290, being the case in which the principle was first definitely stated, cf., however, *Union Metal Manufacturing Co.* v. *Commissioner,* 1 B. T. A. 395, 400; *Deltox Grass Rug Co.* v. *Commissioner,* 7 B. T. A. 811, 815–816; *R. Hoe & Co.* v. *Commissioner,* 7 B. T. A. 1277, 1289; *Weser Bros., Inc.* v. *Commissioner,* 12 B. T. A. 1394, 1399; *Western Wheeled Scraper Co.* v. *Commissioner,* 14 B. T. A. 496, 502; *National Water Main Cleaning Co.* v. *Commissioner,* 16 B. T. A. 223, 241; *Syracuse Food Products Co.* v. *Commissioner,* 21 B. T. A. 865, 890; *Standard Conveyor Co.* v. *Commissioner,* 25 B. T. A. 281, 283; *Prophylactic Brush Co.* v. *Commissioner,* 25 B. T. A. 676, 686; *Hazeltine Corp.* v. *Commissioner, supra* (32 B. T. A. p. 19). So far as we know, the Tax Court's application of this formula has never before been questioned in an appellate court.

A second rule has been developed, no doubt as an outgrowth of the average life formula, in cases where

there was a principal patent or patents to which all others were referable. In such cases, the allowances have been spread over the life of the principal patent or patents rather than over the average life of all of them. *Individual Towel & Cabinet Service Co.* v. *Commissioner,* 5 B. T. A. 158, 162–163; *Hartford-Fairmont Co.* v. *Commissioner,* 12 B. T. A. 98, 103; *Hyatt Roller Bearing Co.* v. *United States,* 43 F. 2d 1008, 1019 (C. Cls.); *Hazeltine Corp.* v. *Commissioner,* 32 B. T. A. 110, 120–121, affirmed on this point 89 F. 2d 513, 521 (C. C. A. 3d); *Heberlein Patent Corp.* v. *United States* (S. D. N. Y.), decided March 9, 1938 (23 A. F. T. R. 1132, 1137), affirmed on another point, 105 F. 2d 965 (C. C. A. 2d); *Addressograph-Multigraph Corp.* v. *Commissioner,* decided February 5, 1945 (1945 P–H T. C. Memorandum Decisions, par. 45,058).

On the other hand, the Simmons formula for which taxpayer contends, permits the spreading of the depreciation deductions over a period represented by the combined lives of all of the patents, allocating to each year in such period a fraction of the cost of the group, as already explained. While referring (p. 642) to the *Union Metal Manufacturing Co.* case, *supra* (4 B. T. A. 305), on the question of group valuation, the Board of Tax Appeals said in the *Simmons* case (p. 644) that it saw no reason why the method agreed upon by the parties as the proper method of calculating the deduction should not be used in that case, the only contested issue being as to patent value.

However, in establishing the value of the group of the 131 patents in question in the *Simmons* case, the evidence was exhaustive as to the relative value of various groups of patents within the group. Thus the evidence disclosed that the useful life of certain of the patents continued after their expiration because of later improvement, and, furthermore, that the last patent issued was the most important of all, since it revivified, so to speak, the entire patent structure.[8] Thus what appears to have been a singular situation was presented in the *Simmons* case, a situation which not only was without precedent, but is without parallel since. Accordingly, it has never, so far as we are aware, been applied in any other case; and, certainly, the facts in the case at bar do not present the slightest resemblance to those in that case.

The taxpayer's Exhibit 8 is a list of the thirty patents owned by Mitchell of California which the taxpayer purchased on September 27, 1929. The exhibit shows that three of these expired as early as 1936 and the others in subsequent years, the last expiring in 1950. Thus the three first had only seven years to run, the last six the full seventeen years, and the rest from eight to sixteen years. The combined lives of the patents in the taxpayer's hands was twenty-one years.

The taxpayer does not claim that the statute, Sec-

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[8] On the other hand, where the last patent was the principal one, and all prior patents and patent applications became merged therein, the amortization period of the group was held to have been the life of the last one. *Individual Towel & Cabinet Service Co.* v. *Commissioner*, *supra* (5 B. T. A., p. 162–163); *Prophylactic Brush Co.* v. *Commissioner*, *supra* (25 B. T. A., p. 686).

tion 23 (l) of the Internal Revenue Code, *supra,* specifically requires that the allowance be spread over the combined lives of all of the patents. Indeed, as the Tax Court pointed out in its opinion, the statute provides no formula by which to compute amortization of patent cost, particularly where, as here, a group of patents was purchased. (R. 67.) The taxpayer's sole claim (Br. 30–35) is that the applicable Regulations, already referred to, so require. But, as stated, these Regulations purport to deal only with a case involving depreciation allowances in respect of a single patent and have uniformly been held inapplicable where, as here, a number of patents expiring at different dates, and having different lengths of life in the taxpayer's hands, are purchased in a group.

However, the taxpayer contends (Br. 31) that, because under the Simmons formula allowances are made in each year in which one or more of the patents is alive, it is the only formula which satisfies the requirements of the Regulations that allowance be made over the life of each patent. Such contention is, we submit, without merit. For the Simmons formula allocates over the combined patent life period of the group a portion of the value of each patent and thus allocates a portion of the value of each over that portion of the amortization period remaining after its expiration. Indeed, it may also serve to allocate a portion of later patents over a period prior to their issue. In this respect, this formula works on principle no differently from the average life formula. The difference is that the Simmons formula serves to lengthen the amortizable life of the patents, whereas the average life for-

mula serves to shorten it. Thus the question as to whether one or the other should be used resolves itself into a question of the exercise of judgment on the part of the Tax Court in the light of the facts of the particular case. We, therefore, turn to an examination of the facts in this case in order to demonstrate that the Tax Court committed no error in approving the use of the average life formula here.

The following table based on the taxpayer's Exhibit 8 shows the number of patent applications acquired by the taxpayer on July 27, 1929, as well as patents issued in each year from 1919 to 1933, inclusive, when the last one was issued, and the year in which each expired; also the approximate number of years each was owned by the taxpayer before its expiration and the number which expired in each year.

Number of patents and year of issue	Year of expiration	Approximate number of years each patent was owned by taxpayer before its expiration	Number of expired patents at end of each year
3 issued in 1919	1936	7	3 at end of 1936.
4 issued in 1920	1937	8	7 at end of 1937.
4 issued in 1921	1938	9	11 at end of 1938.
2 issued in 1922	1939	10	13 at end of 1939.
0 issued in 1923	1940	----------------	13 at end of 1940.
0 issued in 1924	1941	----------------	13 at end of 1941.
1 issued in 1925	1942	13	14 at end of 1942.
5 issued in 1926	1943	14	19 at end of 1943.
2 issued in 1927	1944	15	21 at end of 1944.
2 issued in 1928	1945	16	23 at end of 1945.
2 issued in 1929	1946	16	25 at end of 1946.
0 issued in 1930	1947	----------------	25 at end of 1947.
3 issued in 1931	1948	17	28 at end of 1948.
1 issued in 1932	1949	17	29 at end of 1949.
1 issued in 1933	1950	17	30 at end of 1950.
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It will thus be seen that at the end of 1939 the lives of thirteen patents had expired and there remained

only seventeen. The situation was the same at the end of both 1940 and 1941, for no patents had been issued which expired in those years.

No evidence was adduced as to the relative importance of the patents, or as to the extent of the dependence of any one of them upon the other. Nor was any attempt made to allocate the cost among the patents, or to divide them into smaller groups for the purpose of valuing them, and there was no evidence that one or more of the earlier patents were not the basic or principal ones; or, contrarywise, that one or more of the later ones were the basic or principal patents, or that, whichever were the basic or principal ones, the improvements made by the others thereon served effectively to continue their monopolistic value during the entire period.

The very determination of the Commissioner as early as 1934 that the average life formula was the proper one to be used here, to say nothing of the taxpayer's acceptance of such determination and its use of the formula during such period, leads fairly to an inference, in the absence of any evidence whatever to the contrary, that one or more of the earlier patents were the basic patent or patents and that the others merely constituted improvements or additions thereto, which to a large extent depended for their value upon the continued existence of the earlier patent or patents.[9]

[9] The average life of the patents was 12.3666 years, as stated, and the cost as determined by the Commissioner $1,180,157.59. The yearly allowance was therefore $95,430.50, which was arrived at by dividing the cost by 12.3666. Of course, the period began

Indeed, it was only after the cost of the patents as determined by the Commissioner and accepted by the taxpayer had been completely amortized that the taxpayer for the first time asserted that another formula (the Simmons formula) should have been used extending the amortization period to and including the year the last patent will expire, namely, 1950, as stated.

The reason, of course, is that by recomputing the yearly depreciation allowances in accordance with the Simmons formula for the taxable years 1939, 1940 and 1941 (the years here open to possible recomputation), the taxpayer will gain a tax advantage not only in the taxable year 1941, but in subsequent taxable years, as well. However, by the application of the Simmons formula to the $1,180,157.59 cost figure approved by the Tax Court in its opinion (or even to the corrected figure of $1,235,178.95), the taxpayer would lose the tax advantages it now has in 1939 and 1940, and gain little in 1941. This is so because it received larger allowances in 1939 and 1940 by using the average life formula than it would receive in those years by the use of the Simmons formula, with the result that the depreciation allowance in 1941 under the Simmons formula would be more than

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on July 27, 1929, the date the patents were purchased by the taxpayer, and it ended in the latter part of 1941. Hence an allowance of $95,430.50 would normally have been made in 1940, and one of a slightly smaller amount in 1941. However, due to allowance in excess of $95,430.50 in prior years, the entire cost had been amortized prior to 1941, and all of it except $49,187.34 prior to 1940. Hence, the allowance for 1940 made by the Commissioner in his deficiency determination was in that amount, none being allowed in 1941. (R. 14, 55.)

offset by the resultant reduction of the amount of the net loss carry-over from 1939 and 1940 to 1941. It is to be noted that such net loss carry-over resulted only from the fact that the allowance on account of patent depreciation in 1939 was $95,430.50, and in 1940 $49,187.34. But, as indicated, the allowances for 1939 and 1940 will be materially reduced if the Simmons formula is used. For the case of *Virginian Hotel Co.* v. *Helvering,* 319 U. S. 523, prevents the application of the Simmons formula, or any other formula than that used, to any year prior to 1939, since, as stated, no years prior thereto are open for consideration here, or otherwise. Therefore, if the Simmons formula is now used, the aggregate amount of the deductions allowed prior to 1939 cannot be disturbed although these are in excess of the aggregate amount allowable, and although the taxpayer may not have derived any tax advantage therefrom.

Thus, at the end of 1938, there remained only $144,617.84 undepreciated cost, being the difference between $1,180,157.59 cost figure approved by the Tax Court and the $1,035,539.75 which was allowed to December 31, 1938 (R. 14, 55), $95,430.50 in 1939, and $49,187.34 in 1940. It would, therefore, at best, be only this difference (adjusted by the addition of $55,021.36) which could be amortized subsequent to 1938 by the application of the Simmons formula. And, to amortize that amount over the years 1939 to 1950, would reduce annual allowances in those years to about $12,000 (or to about $16,000 if the adjusted figure is used), wiping out the net losses for 1939 and 1940 and hence the net loss carry-over from those years to 1941.

It follows that the taxpayer would gain a tax advantage in 1941 only to the extent of a deduction of \$12,000 (\$16,000) on account of patent depreciation. It would, therefore, be necessary, in order for the taxpayer to obtain any great advantage from the use of the Simmons formula, that its patent cost be increased, as it contends it should be, from the \$1,180,157.59 figure to the \$2,860,178.95 figure, which it now claims.

In the event the latter figure is used, the adoption of the Simmons formula may require a recomputation of the annual allowances over all of the years from 1929 to 1950, inclusive. For the *Virginian Hotel Co.* case may not serve to prevent it, since the allowable deductions would then be greater in each year than those which were actually allowed, the reverse of the situation in *Virginian Hotel Co.* case.

Of course, all this is academic if, as we believe we have shown, there is no evidence whatever which would justify the use of the Simmons formula, to say nothing of the fact that, even if there were some evidence to justify its use, whether it should nevertheless have been used would still have been a matter resting solely within the judgment of the Tax Court. Cf. *Commissioner* v. *Rainier Brewing Co.,* 165 F. 2d 217 (C. C. A. 9th), rehearing denied February 18, 1948 (1948 C. C. H., par. 9184) and the companion case of *Seattle Brewing & Malting Co.* v. *Commissioner,* 165 F. 2d 216 (C. C. A. 9th) rehearing denied February 18, 1948 (1948 C. C. H., par. 9188). Moreover, since the Tax Court here (similarly as in the *Simmons Co.* case) merely approved the formula used by the Commissioner and the taxpayer in computing annual patent

depreciation allowances (R. 66–67), it is obvious that its decision can have little value as a precedent (see *Commissioner* v. *Scottish American Co.,* 323 U. S. 119), for it lays down no rule of general applicability which is reviewable (see *Trust of Bingham* v. *Commissioner,* 325 U. S. 365).

We, therefore, submit that, however the matter may be approached, the Tax Court's approval of the use by the Commissioner and the taxpayer of the average life formula in computing the taxpayer's patent cost depreciation allowances presents nothing for review.

B. Except for conceded adjustment, the evidence sustains the Tax Court's finding that the taxpayer's patent cost was $1,180,157.59

The taxpayer's contention is (Br. 14–18) that it paid $3,100,000 for all of the assets of Mitchell of California, and that the contrary conclusion of the Tax Court has no support whatever in the record. Accordingly, it further contends (Br. 18–24) that it paid $2,860,178.95 for the patents, being the difference between the $3,100,000 paid by it for all of the assets of Mitchell of California and the stipulated value of its tangible assets of $239,821.05. We think the record lends no support to this conclusion; but, if it does, then that there is ample evidence from which the Tax Court could have reached a conclusion that the taxpayer's cost of all the assets of Mitchell of California was $1,475,000, of which the cost of the patents was $1,180,-157.95, subject to the adjustment which we have conceded. However, for the sake of simplicity, we use the uncorrected figure here, since that was used throughout the trial of the case, as well as in the Tax

Court's findings and opinion and in the taxpayer's brief. The facts supporting the Tax Court's finding that the taxpayer's patent cost was $1,180,157.59 are as follows:

Originally, as stated, the taxpayer set up on its books a patent cost figure of $55,021.36 and good will at $2,805,157.59, making a total of the $2,860,178.95, the patent cost figure now claimed by the taxpayer. Accordingly, in its income tax returns for the taxable years 1929, 1930 and 1931, the taxpayer stated the cost of its patents in amounts based on the $55,021.59 figure and made claims for patent depreciation allowances on that basis. (R. 49–50.) In 1932, however, it reported the net value of its patents to be $1,344,833.11 at the beginning of the year and $1,345,909.91 at the end. These figures reflected a write down of good will of $1,250,000 and a corresponding write-up of patent values. (R. 52.)

Thereafter, in 1934, the Commissioner adjusted the patent value, or cost, figure to $1,180,157.59, representing the amount of $1,475,000, which Clarke had paid—as the Commissioner contends for the taxpayer—to Mitchell of California for all of its assets, less $294,842.41, which he then determined as representing the value (purchase price) of its tangible assets. (R. 51.) We have already conceded that this should have been the stipulated figure of $239,821.05 (R. 23), the difference being the $55,021.36 figure above referred to. However, the $1,180,157.59 figure determined by the Commissioner as the taxpayer's patent cost was accepted by it (R. 51–52), and it was

upon the basis of that figure that its 1930 and 1931 allowances for patent depreciation were recomputed, no change being made by the Commissioner, however, in the allowance the taxpayer had claimed for 1932. Accordingly, in its returns for 1933 to 1940, inclusive, the taxpayer claimed and was allowed depreciation upon an original patent cost of $1,180,157.59, plus whatever additions had been made thereto during these years. (R. 14, 55.)

Here then we have a continuous formula declaration on the part of the taxpayer covering a period of eleven years from 1930 to 1940, inclusive, specifically reiterated in its returns for 1933 to 1940, inclusive, that its cost of the Mitchell of California assets was $1,475,000, and its cost of the latter's patents $1,180,157.59.

The reason for now asserting that these figures do not after all correctly represent the cost of such assets and of the patents should also be taken into consideration. It is, as stated, that an acceptance of the larger patent cost figure will give the taxpayer important tax advantages not only in 1941, but in subsequent years to and including 1950, as well, which it would not otherwise be able to obtain. What then is the basis of the taxpayer's assertion that the heretofore agreed to and used patent cost figure is not the correct one, but that the one it now contends for is?

Clarke was apparently the brains behind the organization of a corporation known as the General Theatres Equipment, Inc. (G. T. E.), organized to finance the purchase not only of the assets of Mitchell of California but of those of a number of other concerns manufacturing equipment used by the moving picture

industry in the production of moving pictures. In this venture, he interested William Fox, but apparently only on condition that the latter would receive a substantial interest therein without actually costing him anything.

Pursuant to an agreement reached between Clarke and Fox, in furtherance of the scheme, for the acquisition of the assets of Mitchell of California, each deposited $50,000 in escrow to be paid to the owners of that company, Boeger and Mitchell. G. T. E. was then organized by Clarke who received "just over control" of its stock (R. 38), and some $11,000,000 of its securities were sold to the public, of which $5,000,000 was placed at Clarke's disposition, $2,000,000 of which was earmarked for the purchase (directly or indirectly, as the case might be) of the assets of Mitchell of California and $3,000,000 for the purchase of the assets of four lamp companies. Clarke also organized a corporation called Grandeur, one-half of whose stock was to be acquired by himself, for himself and Fox, and the other half by G. T. E. And, finally, Clarke organized the taxpayer all of whose stock was to be owned by Grandeur.

Out of the $5,000,000 Clark made the following disbursements. He first gave a check to Fox for $2,000,000. Out of this Fox reimbursed himself for the $50,000 original payment made by him in escrow for the benefit of the owners of Mitchell of California. The balance of $1,950,000 Fox paid to Grandeur. Clarke then matched this payment by also giving a check for $1,950,000 to Grandeur. Thus Grandeur received altogether $3,900,000, all paid out of the

$5,000,000 fund which Clarke had received from G. T. E. But, of the $3,900,000 received by Grandeur, it permanently retained only $900,000. The balance of $3,000,000 was paid by it to the taxpayer for the latter's stock, and the taxpayer immediately returned this amount to Clarke in ostensible payment for the assets of Mitchell of California which Clarke, however, did not purchase until later for $1,475,000, also paid out of the $5,000,000. Of the $1,475,000, $1,375,000 was represented by a check given by Clarke to Boeger and Mitchell directly, to which should be added the $50,000 paid by Clarke to Fox for the purpose of reimbursing him for the latter's original payment in escrow for the benefit of Boeger and Mitchell, as well as the $50,000 paid by Clarke to Boeger and Mitchell for which he was also reimbursed. (R. 59.)[10]

It is thus apparent that $3,000,000 of the amount paid by Clarke either directly or to or through Fox was immediately returned to him after passing through Grandeur and the taxpayer. Obviously, the sole purpose of passing this amount through Grandeur

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[10] In the Tax Court's opinion, the check drawn by the taxpayer to Clarke for the assets of Mitchell of California is stated to have been $3,100,000 (R. 59) which is also the amount given in Clarke's offer to sell these assets to the taxpayer, which the latter accepted. But no such amount appears in Clarke's bank account. (Commissioner's Exhibit W; R. 133–134.) There the figure is $3,000,000. (R. 46–47.) See also the taxpayer's Exhibit 15, which is Grandeur's check to the taxpayer for $3,000,000. (R. 105.) It is nowhere explained how the taxpayer got the other $100,000. The taxpayer's bank account shows the deposit of Grandeur's check for $3,000,000 and on the same day a withdrawal of that amount represented by a check to Clarke, leaving no balance. (R. 46–47.)

and the taxpayer was to permit the making of bookkeeping entries showing payments of that amount to both Grandeur and the taxpayer and thus *pro forma* to justify, on the one hand, the purchase by Grandeur from the taxpayer of $3,000,000 par value of the latter's stock for $3,000,000, and, on the other hand, the purchase by the taxpayer from Clarke of the assets of Mitchell of California for that amount.

Actually, of course, no more than $1,450,000 was paid by anyone for the assets of Mitchell of California, for at no time was $3,000,000 in actual cash available for that purpose; and, in final analysis, the $1,475,000 was paid by Clarke for the taxpayer.

As regards Clarke's functions in this matter, the taxpayer argues (Br. 16) that Clarke personally made a profit out of this transaction and that there is no justification for excluding such profit from the taxpayer's cost merely because his promotional activities may have put him in better position to make the sale, and therefore to realize the profit for himself than anyone else. Accordingly, the taxpayer asserts (Br. 17) that Clarke's transactions with, and interest in, other corporations are not relevant to and do not alter the fact that he sold the assets in question—that is, for his own account—to the taxpayer for $3,100,000 (sic). It concludes (Br. 17) that the fact that he personally sold the property to the taxpayer, i. e., for that amount conclusively determines the taxpayer's cost and, therefore, its basis for patent amortization.

But what the taxpayer has overlooked is that Clarke testified he made no profit out of any of the transac-

tions of G. T. E., and by this statement he unquestionably meant to include his purchase from Boeger and Mitchell of the assets of Mitchell of California, as well as their sale to the taxpayer. (R. 124.) For he had already testified that the intention was that during the period he owned the Mitchell Camera Company of California (meaning its assets), and before it was turned over to the taxpayer, he owned it as agent for G. T. E. (R. 120.) We turn then to the question whether \$3,000,000, or more than \$1,475,000, was ever actually available for the purchase of the assets of Mitchell of California.

As we have said, all payments for the acquisition not only of the assets of Mitchell of California, but for the purchase of the four lamp companies, as well, were made out of the \$5,000,000 fund which G. T. E. had placed at Clarke's disposal for that purpose. Indeed, Clarke himself so testified (R. 125), although he had theretofore stated that the payment he had made to Fox of \$2,000,000 came out of his personal funds (R. 123). But this was obviously not true, if thereby he meant to say that he did not pay the amount out of the \$5,000,000 he had received from G. T. E. In any case, the Tax Court on a review of all of the evidence specifically found that the payment made by Clarke to Fox of \$2,000,000 came out of that fund (R. 45–46), and there can be no question, we submit, that this finding is in strict accordance with the facts.

Of course, Clarke also testified that the payment of \$1,475,000 paid to Boeger and Mitchell for the assets

of Mitchell of California and the payment for the four lamp companies, stated by him to have been $1,699,-000 (cf. R. 122, where he said that the exact amount was $1,699,422.93), were made out of the fund, except that he stated the amount of the fund to have been $6,100,000 instead of $5,000,000. (R. 125.) There can, of course, be no question that the fund was $5,000,000 (R. 117), and so the Tax Court found (R. 45), although here again Clarke confused this fact by his statement, on the one hand, to the effect that he had paid from $350,000 to $400,000 as commissions in the acquisition of the assets of Mitchell of California and, on the other, that he had also paid "perhaps a couple of hundred thousand" in commissions in the acquisition of the four lamp companies, and by further immediately thereafter stating that G. T. E. had acquired the four lamp companies and its interest in Grandeur for around $5,322,000 (R. 118). But the fact of the matter is that Clarke paid exactly $1,757,-422.93 for the four lamp companies, and so the Tax Court found. Indeed, the Tax Court was able from the evidence to and did break down this figure into the payments made to each of the four companies. (R. 48.)

The following table, set up in three columns, shows how both the purchase of the assets of Mitchell of California and that of the four lamp companies was financed, and how $3,000,000 of the total payment of $3,900,000 made out of the fund to Grandeur by Clarke directly and through Fox, and by Grandeur to the taxpayer, was washed out by the taxpayer's return of it

to Clarke and the latter's redeposit of the amount in his personal bank account in which the $5,000,000 fund had been deposited. The first column in the table shows the manner in which Clarke used the $5,000,000 fund to finance the purchase by Fox of a one-half interest in Grandeur and by G. T. E. of the other half, as well as Grandeur's acquisition of all of the stock of the taxpayer, and the latter's acquisition through Clarke of the assets of Mitchell of California, as also the acquisition by G. T. E. of the four lamp companies. The second column shows the actual permanent distribution of moneys out of the fund, aggregating $4,132,422.93, and the last column the actual unexpended balance of $867,577.07. The last column shows the $5,000,000 received by Clarke from G. T. E., as well as the return to Clarke of $3,000,000 thereof through the taxpayer. The washing out of this amount is shown in stricken-through type in both the first and last columns.

The financing of Grandeur; the acquisition of half of its stock for Fox and the balance for G. T. E.; the acquisition of the assets of Mitchell of Cal. for the taxpayer, and of the four lamp companies for G. T. E.		Actual outlays made by Clarke	Deposits in and total actual withdrawals from Clarke's bank account
August 1			
Received by Clarke from G. T. E. for acquisition of assets of Mitchell of Cal	$2, 000, 000		
And of the 4 lamp companies	3, 000, 000		$5, 000, 000
Clarke gave Fox $2,000,000 out of which Fox reimbursed himself for payment made to Boeger and Mitchell 6/6/29	50, 000	$50, 000	
Balance of $2,000,000 received by Fox from Clarke paid to Grandeur for one-half of its stock	1, 950, 000		
Clarke also paid to Grandeur on behalf of G. T. E. for remaining half of its stock	1, 950, 000		
Total paid Grandeur	3, 900, 000		
Of which Grandeur retained	900, 000	900, 000	
Balance paid by Grandeur to the taxpayer for all of its stock and by the latter to Clarke, who redeposited it on Aug. 2	~~$3, 000, 000~~		~~3, 000, 000~~
Clarke also received back the $50,000 initial payment he had made to Boeger and Mitchell	50, 000	50, 000	
August 24			
Bal. paid by Clarke to Boeger and Mitchell for assets of Mitchell of Cal	1, 375, 000	1, 375, 000	
Date not given			
Paid by Clarke to acquire 4 lamp companies for G. T. E.	1, 757, 422. 93	1, 757, 422. 93	
Total actual outlays made by Clarke		4, 132, 422. 93	4, 132, 422. 93
Unexpended balance			867, 577. 07

It is thus apparent that the passage from Clarke to Grandeur (one-half through Fox); from Grandeur to the taxpayer, and from the latter back to Clarke, was a device to accomplish three things: (1) the repayment to Fox of the $50,000 he had paid to Boeger and Mitchell; (2) the giving to Fox of a one-half interest in Grandeur, free of cost to him, and (3) the payment to Grandeur of $900,000 for its treasury; the remaining half interest in Grandeur being taken by Clarke for G. T. E., of which Clarke owned one-half, as stated.

Actually, therefore, the only consideration the taxpayer paid for the assets of Mitchell of California was its capital stock, which the taxpayer issued to Grandeur in pursuance of the agreement made between Clarke and Fox on May 24–25, 1929, that such assets should be purchased by Clarke pursuant to negotiations he was then conducting with Boeger and Mitchell. (R. 29–31.) And such negotiations culminated, as stated, in Clarke's purchase of these assets for $1,475,000, pursuant to his June 6, 1929, agreement with Boeger and Mitchell. (R. 31–34.) Moreover, for what it is here worth, these assets were transferred by Mitchell of California directly to the taxpayer, and on July 27, 1929, that is, six days prior to the financial transactions between Clarke, Fox, Grandeur and the taxpayer, and nearly a month before Clarke made the final payment on August 24, 1929, to Boeger and Mitchell of the $1,375,000 with interest. (R. 43.) If more than this were needed to show the unreality of the purported $3,000,000 payment by the taxpayer to Clarke for these assets, it may further be

pointed out that such payment appears to have been made before Clarke had even given his $2,000,000 check to Fox, and before he and Fox had each given his check for $1,950,000 to Grandeur. For an examination of Clarke's bank account disclosed that the $3,000,000 check he had received from the taxpayer was deposited by him before he withdrew the $2,000,000 he paid to Fox and the $1,950,000 he paid to Grandeur. Without doubt, therefore, the Tax Court correctly evaluated the situation when it said in its opinion that the only arm's-length transaction in this shuffle of checks was that between Clarke and Boeger and Mitchell. (R. 63.) Thus, if in this case the taxpayer's claim that the amount of $3,000,000 must be accepted as representing the cost of Mitchell of California's assets, then any other amount which Clarke and Fox might have decided upon would have had to be accepted, provided only that its payment had taken the ring-around-the-rosy course which the $3,000,000 payment here in question did.

The case of *Commissioner* v. *Matheson*, 82 F. 2d 380 (C. C. A. 5th), which the taxpayer cites (Br. 17) and apparently relies on heavily to support its contention that the $3,000,000 payment by the taxpayer to Clarke must be accepted as representing its cost of the Mitchell of California assets, is obviously not in point. For taxpayer in that case actually relinquished a legacy of a value of $130,700 for certain stock even though the stock did not have a market value of that amount. As we have shown, the taxpayer here never actually had $3,000,000 and besides

the assets of Mitchell of California were bought by Clarke for taxpayer, not for himself, for $1,475,000.

This leaves for consideration on this phase of the case the question whether the taxpayer's cost of the assets of Mitchell of California should also be increased by $350,000 or $400,000, which Clarke said he had paid as commissions in acquiring them. The taxpayer argues (Br. 27–29) that the evidence conclusively establishes that Clarke paid out either the one or the other amount in commissions, and that at least the smaller amount, or perhaps some other still smaller amount should have been added to its cost, citing *Cohan* v. *Commissioner,* 39 F. 2d 540 (C. C. A. 2d), and *Isbell Porter Co.* v. *Commissioner,* 40 F. 2d 432 (C. C. A. 2d).

However, the fact that Clarke paid out any amount in commissions in connection with the acquisition of these assets is not conceded; nor is the fact that some amount was actually given established, as it was in the cited cases. The Tax Court disposed of the taxpayer's contention that Clarke did make such payments by reviewing Clarke's testimony on this point in its opinion, and by its comment thereon that it thought more evidence than that was required upon which to base a finding of additional cost by reason of commissions paid. In reviewing the evidence on this point, the Tax Court pointed out that there was no evidence to show to whom the commissions had been paid; that they were vaguely described as aggregating between $350,000 and $400,000, and that, at the hearing before a Senate Committee, the evidence was

that, in all, $100,000 had been paid in connection not only with the acquisition of the assets of Mitchell of California, but of other corporations by G. T. E., but that there was no showing that even any part of that amount had been paid in connection with the transactions here in question. (R. 64–65.)

The taxpayer asserts (Br. 28) that the Tax Court did not intimate that it discredited Clarke's testimony, even if it had been at liberty to do so. But we submit that it not only did discredit such testimony but that it was at liberty to do so. There is, moreover, no merit to the taxpayer's contention that the burden of proof was upon the Commissioner to elaborate Clarke's testimony, since it was given while he was testifying as a Government witness. But this was an issue posed by the taxpayer in its amended petition. (R. 7.) Furthermore, Clarke was actually the taxpayer's principal witness, and was called by the Government only to develop certain facts, which had not been developed by the taxpayer. He volunteered the information that he had paid these commissions while testifying as the Commissioner's witness, and the matter was not pursued by the taxpayer. In any event, his testimony on this point cannot be reconciled with his other testimony. For he also testified that he paid $200,000 in commissions for the acquisition of the four lamp companies. If so, he paid altogether between $550,000 and $600,000 in commissions. As we have already shown, Clarke actually paid out $4,132,422.93 in the acquisition of the assets of Mitchell of California and the four lamp companies. If the

$550,000 or $600,000 is added to that, the total amount paid would be either $4,682,422.93 or $4,732,422.93, depending on which figure is added. But Clarke testified immediately after having testified as to the payment of these commissions that G. T. E. had acquired the four lamp companies and the interest in Grandeur for "five million three hundred and twenty-two thousand odd dollars." (R. 18.) Not only that, but thereafter he testified, as we have already said, that he had paid $1,699,000 for the lamp companies, $1,475,000 plus $350,000 or $400,000 for Mitchell, making a total of $3,524,000 or $3,574,000 as the case may be. (R. 125.) If we add the $200,000 he said he paid as commissions in connection with the purchase of the four lamp companies, we now have a total of $3,724,000 or $3,774,000, as the case may be, which obviously bears no relation whatever to the $5,322,000 figure he had first given. (R. 118.)

Is it possible that, in these circumstances, the Tax Court was compelled to believe this witness when he said that he had paid between $350,000 and $400,000 as commissions in connection with the acquisition of the assets of Mitchell of California? Would a jury have been required to find that he had paid either sum, or any sum? The obvious answer is in the negative. It is well settled that the Tax Court need not accept as absolutely true the self-serving statements of interested witnesses, even though they are not impeached by direct contrary evidence. Indirect evidence may in itself be, and in this case certainly is, sufficiently contradictory thereof to warrant the Tax

Court in rejecting it. See *Quock-Ting* v. *United States,* 140 U. S. 417, 420; *Helvering* v. *Nat. Grocery Co.,* 304 U. S. 282, 285; *Helvering* v. *Stock Yards Co.,* 318 U. S. 693, 701; *Cohen* v. *Commissioner,* 148 F. 2d 336 (C. C. A. 2d); *Andrew Jergens Co.* v. *Conner,* 125 F. 2d 686, 689 (C. C. A. 6th); *Birnbaum* v. *Commissioner,* 117 F. 2d 395 (C. C. A. 7th); *Rand* v. *Helvering,* 77 F. 2d 450 (C. C. A. 8th); *United States* v. *Washington Dehydrated Food Co.,* 89 F. 2d 606 (C. C. A. 8th).

The only remaining question is whether, when the Tax Court said that it thought more evidence than that which Clarke had given on the subject was required upon which to base a finding of additional cost by reason of commissions paid, it was not in effect saying that it did not believe Clarke's testimony in this respect. This is a wholly fallacious assumption, for as the Supreme Court in *Stone* v. *United States,* 164 U. S. 380, 382, pointed out, to say, as the Tax Court did in effect, that the evidence of Clarke did not satisfactorily explain the transaction is more polite and less offensive than to say that it did not believe the witness, and at the same time equally suffices.

We, therefore, submit that there is ample evidence to sustain the Tax Court's finding that the taxpayer's patent cost was the amount $1,180,157.59, plus, of course, the amount of $55,021.36, as we have conceded.

II

The Administrative Procedure Act has no application here

The taxpayer contends that both the Tax Court's procedure and the review of its decisions by this Court

are governed by the so-called Administrative Procedure Act, c. 234, 60 Stat. 237. Its primary reliance in support of such contention is the Sixth Circuit's moribund dictum in *Lincoln Electric Co.* v. *Commissioner,* 162 F. 2d 379.

A short answer, however, so far at least as this case is concerned, is that, in virtue of Section 12, the Act has no application to any proceeding instituted prior to its effective date, as is the case here. For, so far as concerns us here, Section 12 provides that the Act shall take effect three months after its approval. The Act was approved June 11, 1946. Accordingly, its effective date is September 11, 1946, and this proceeding was initiated by the taxpayer in the Tax Court on May 15, 1945.

Even so, the Sixth Circuit's dictum is erroneous and has not been followed either in that Circuit or in any other. Indeed, the Seventh Circuit has expressly rejected it as unsound in *Anderson* v. *Commissioner,* 164 F. 2d 870. The court there pointed out that such dictum had obviously not even been accepted by all of the judges of the Sixth Circuit.

Moreover, in *MacDonald* v. *Commissioner,* 165 F. 2d 213, the Sixth Circuit has itself implicitly rejected a contention that the procedural provisions of Section 8 of the Act are applicable to the Tax Court. For in that case it affirmed the Tax Court by a *per curiam* decision rendered within two days after the argument, although similarly as here, the Tax Court had rejected the taxpayer's contention that it must comply there-

with and the Sixth Circuit was appealed to to reverse the Tax Court's decision on that point.

However, a letter written by the Attorney General to the Chairman of both the House and Senate Judiciary Committees states the Government's position in this matter. It is that the procedural provisions of the Administrative Procedure Act do not apply to the Tax Court nor affect the requirement of resort thereto. See S. Doc. 248, 79th Cong., 2d Sess., entitled Administrative Procedure Act, Legislative History, pp. 224, 408. This is so, although the Tax Court is not technically a court, but an independent administrative tribunal exercising quasi-judicial functions in reviewing deficiency determinations of certain taxes made by the Commissioner of Internal Revenue. See *Commissioner* v. *Gooch Co.,* 320 U. S. 418, and authorities there cited. The legislative history of the Act amply bears out the Attorney General's view of the matter. (S. Doc. 248, pp. 202, 214, 260, 279, 332, 334, 359, and 370.)

In any event, Congress did not intend in anywise to modify existing statutory methods of review (S. Doc. 248, p. 15), and the so-called "substantial evidence" rule was in nowise intended to be changed thereby (S. Doc. 248, pp. 30, 39, 208, 230, 270, 279, 349, 370, 410 and 415).

CONCLUSION

For the reasons stated, the case should be remanded to the Tax Court but only to recompute the taxpayer's patent depreciation allowance, if any, for the year

1941, upon the basis of a patent cost computed by adding $55,021.36 to the cost determined by the Tax Court in the sum of $1,180,157.59. In all other respects, however, the Tax Court's decision should be affirmed.

Respectfully submitted.

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